

## APPENDIX 6

### Correspondence From Acting SEC Chairman Laura Unger to Representative Frank Wolf (With Attachment)



THE CHAIRMAN

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

May 8, 2001

The Honorable Frank P. Wolf  
U.S. House of Representatives  
241 Cannon Building  
Washington, D.C. 20515-4610

MAY 09 2001

Dear Congressman Wolf:

This letter responds to our meeting and your letter of April 2, 2001, regarding PetroChina Company, Ltd., Talisman Energy, Inc., and proposed disclosure requirements for foreign firms that seek access to the U.S. markets. I have asked David Martin, Director of the Commission's Division of Corporation Finance, to review your recommendations for additional disclosure for foreign companies. His memorandum is enclosed.

I would like to take this opportunity to brief you on some of the efforts the Commission staff has undertaken regarding Sudan following our meeting and your letter of April 2, as well as several initiatives we intend to pursue in the near future:

#### Actions To Date

- We met and have had ongoing communications with Roger Robinson of the William J. Casey Institute of the Center for Security Policy. Mr. Robinson provided us with additional information about the recommendations in your letter and offered some useful suggestions for interagency cooperation on issues involving Sudan and, more generally, on issues involving national security, human rights and religious freedom. His ideas have proven useful in our outreach to other government agencies, as discussed further below.
- We had a meeting with the staff of the U.S. Commission on International Religious Freedom ("CIRF"). In response to their inquiries we have assisted them in understanding both the fundamentals of the SEC's disclosure-based system and specific disclosure rules and practices in which CIRF has an interest. We are reviewing carefully CIRF's reports of March and May 2001.
- We received a State Department briefing on both the history of the war in Sudan and current conditions there. It was a comprehensive briefing by representatives of the Bureau of Democracy, Human Rights and Labor; the Bureau of African Affairs; and the Office of International Religious Freedom. Over 20 members of

the SEC staff attended the briefing, including members of the Division of Corporation Finance staff who are responsible for reviewing filings.

- Last week, we met with the Director and staff of the State Department's Office of International Religious Freedom. Representatives from other State Department offices attended as well. We discussed some of our efforts to improve disclosure regarding the activities of foreign companies in Sudan, and we raised the possibility of interagency cooperation on Sudan. The Office of International Religious Freedom expressed support for an interagency working group.
- We spoke with officials in the U.S. Treasury Department's Office of Foreign Assets Control ("OFAC") to learn more about the existing sanctions regime and its application to transactions with Sudan. We have also begun discussions with OFAC about a possible interagency working group.
- I have met with the Directors of each of the SEC's divisions to discuss your concerns regarding the situation in Sudan. They are sensitized to this issue and will be looking for creative ways to enhance investors' access to material information about foreign investment in Sudan and its impact on the human rights situation there.
- Supervisors of the review staff in the Division of Corporation Finance have been made aware of issues concerning Sudan. They are, in turn, working with their staff to be attentive to disclosure in registered offering documents and periodic reports regarding material business or use of proceeds in Sudan and other countries subject to U.S. economic sanctions.

#### Initiatives to be Undertaken

##### 1. Rulemaking to Require Electronic Filing by Foreign Companies

As you know, foreign companies that seek to register with the SEC may elect to make their filings on paper, rather than electronically through the SEC's EDGAR system. Paper filings are available to the public through our reference facilities, but they are not available through our website and cannot be searched electronically. To facilitate investor access to filings by foreign companies, as well as the staff's efficiency in reviewing those filings, I have asked the staff to prepare for the Commission promptly a proposed rulemaking to require foreign companies to file electronically on our EDGAR system.

##### 2. Review of Registration Statements Filed by Companies Doing Business in Countries Subject to U.S. Economic Sanctions

All registration statements relating to public offerings of securities are legally subject to review by the staff of the Commission's Division of Corporation Finance. The

staff has, however, exercised its discretion to perform only a selective review of such filings, due to limited Commission resources. Because of the complex issues involving national security, human rights and religious freedom that have been raised in connection with countries subject to U.S. economic sanctions, our staff has decided that it will attempt to review all registration statements filed by foreign companies which reflect material business dealings with governments of countries subject to U.S. economic sanctions administered by OFAC, or with persons or entities in those countries.

### 3. Enhanced Disclosure for Foreign Registrants Doing Business in Sanctioned Countries

U.S. sanctions administered by OFAC prohibit American companies from investing or doing business in Sudan. Those sanctions do not, however, prohibit foreign companies from doing so. Foreign companies that do business in Sudan, or any other country subject to OFAC sanctions, may list on U.S. securities exchanges and offer their stock to investors in U.S. markets. The SEC does not have statutory authority to deny access to the U.S. markets to any foreign company on the basis of its involvement with a particular foreign country or government, including Sudan.

The SEC does, however, have statutory authority to require that U.S. investors receive adequate disclosure about where the proceeds of their securities investments are going and how they are being used. The federal securities laws are founded on the principle that the best way to protect investors is to ensure that they have access to *material* information about the companies and securities in which they are considering investing. While there is no "bright line" test for materiality, the Supreme Court has held that information is material if a reasonable investor would be substantially likely to consider that information significant in making an investment decision.

The fact that a foreign company is doing material business with a country, government, or entity on OFAC's sanctions list is, in the SEC staff's view, substantially likely to be significant to a reasonable investor's decision about whether to invest in that company. Therefore, in accordance with existing disclosure rules and the SEC's investor protection mandate, the staff of the Division of Corporation Finance will seek information from registrants about material business in, or with, countries, governments, or entities with which U.S. companies would be prohibited from doing business under economic sanctions administered by OFAC. Our aim is to make available to investors additional information about situations in which the material proceeds of an offering could – however indirectly – benefit countries, governments, or entities that, as a matter of U.S. foreign policy, are off-limits to U.S. companies.

### 4. Communication With OFAC

As a U.S. government agency, the SEC fully supports duly imposed economic sanctions and will cooperate with appropriate U.S. governmental agencies to help ensure that those sanctions are enforced. Accordingly, we will bring to the attention of the

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OFAC staff any disclosure in registration statements filed by foreign companies which reflect material business dealings with countries subject to OFAC-administered sanctions.

#### 5. Interagency Working Group

We would support formation of an interagency working group on Sudan.

#### Requests for SEC Action

We appreciate your sharing with us your concerns that PetroChina and Talisman may have failed to make adequate disclosure in connection with their public offerings concerning use of proceeds and risk. As we have discussed in previous correspondence with you, when PetroChina sought to offer its securities for sale, the Commission's staff reviewed the company's registration statement thoroughly and considered all of the disclosure it contained. The staff was, at that time, aware of your concerns about the offering and paid particular attention to the disclosure regarding risks and use of proceeds. We take very seriously the charge in your most recent correspondence that PetroChina and Talisman may have failed to disclose material information in registration statements and other reports filed with the Commission. We have referred your letter to the Commission's Division of Enforcement.

We recognize and appreciate your concern in this matter, and I assure you that the staff will consider carefully the information you supplied in accordance with the Commission's responsibilities under the federal securities laws. As you know, however, SEC investigations are non-public. As a matter of policy, therefore, the agency does not confirm or deny the existence of a pending inquiry. This policy protects the integrity of the investigative process, in both fact and appearance. See generally SEC v. Wheeling Pittsburgh Steel Corp., 482 F. Supp. 555 (W.D. Pa. 1979), vacated and remanded, 648 F.2d 118 (3d Cir. 1981).

With respect to your request that the Commission suspend trading in PetroChina and Talisman, some general background might be helpful. When Congress enacted the federal securities laws, it gave the SEC limited authority to suspend temporarily trading in an individual security. Securities Exchange Act of 1934 § 12(k)(1)(A), 15 U.S.C. § 78l(k)(1)(A). The Supreme Court has warned that "the power to summarily suspend trading in a security even for 10 days, without any notice, opportunity to be heard, or findings based upon a record, is an awesome power with a potentially devastating impact on the issuer, its shareholders, and other investors." SEC v. Sloan, 436 U.S. 103, 112 (1978). The Court viewed a trading suspension as a "somewhat drastic" measure, to be exercised very cautiously. Id. The Commission's approach to the exercise of its trading suspension authority is consistent with the Court's view.

We note, too, that the sudden loss of liquidity resulting from a trading suspension may impose more significant economic hardship on shareholders than on the listed company itself. A trading suspension only halts secondary market trading. That is, the

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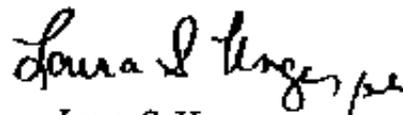
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trading suspension has no effect on the issuers' use of proceeds from prior offerings. Meanwhile, investors wanting to sell their securities -- for reasons ranging from liquidity needs to disapproval of the company's use of proceeds -- cannot do so.

Moreover, for a company with dual listings (one in the U.S. and one offshore), an SEC trading suspension has no effect on a home country market. In such situations, U.S. holders of the securities in which trading has been suspended would likely suffer more serious consequences from a trading suspension. Therefore, the Commission rarely exercises its authority to suspend trading in a security absent evidence of fraud.

We appreciate your dedication to working toward a solution to the crisis in Sudan. I will schedule a meeting with you at your convenience to discuss this issue in further detail. Should you have questions in the meantime, please do not hesitate to contact me at 202-942-0100 or David Martin, Director of our Division of Corporation Finance, at 202-942-2929.

Sincerely,



Laura S. Unger  
Acting Chairman

Enclosure

# MEMORANDUM

May 8, 2001

TO: Acting Chairman Laura Unger

FROM: David B.H. Martin   
Director, Division of Corporation Finance

SUBJECT: Response to letter dated April 2, 2001 from Congressman Wolf

You have asked for the views of the Division of Corporation Finance on the ten recommendations outlined by Congressman Frank Wolf in his letter to you dated April 2, 2001. We address each of these recommendations below.

1. *Global Operations: Foreign companies should disclose their operations – as well as those of their parent companies, subsidiaries and affiliates – in countries which are listed on the following U.S. government lists:*
  - a) *CIA List of Acquiring and Supplying Nations as cited in its annual report to Congress on the Acquisition of Technology Relating to Weapons of Mass Destruction and Advanced Conventional Munitions*
  - b) *U.S. State Department List of Sponsors of Terrorism*
  - c) *U.S. State Department-Designated Countries of Particular Concern for Violations of Religious Freedom*

*Companies should also disclose their business relationships – as well as those of their parent companies, subsidiaries and affiliates – with companies from countries which appear on these lists.*

SEC rules do not require disclosure about business operations in specific countries. Companies filing registered offering documents under the Securities Act of 1933 (Securities Act) or filing periodic reports under the Securities Exchange Act of 1934 (Exchange Act), however, are subject to certain mandated disclosure requirements about their business, which may include disclosure of their operations in specific countries. The following are examples of specific SEC requirements which could result in such disclosure:

- a) A company must make certain disclosures relating to the various countries in which it conducts business. Most U.S. companies are required to provide a breakdown of revenues and long-lived assets by: domicile country, all foreign countries, and any individual foreign country in which revenues and assets are material. A foreign company must provide a description of the principal markets in which it competes, including a breakdown of total revenues by geographic market.

- A company must also make certain disclosures about its recent past and immediate foreseeable future, including any known trends, events or uncertainties -- favorable or unfavorable -- that have had or are reasonably expected to have a material impact on results of the company's operations or to cause a material increase or decrease in the company's liquidity or capital resources. For example, if investors ceased purchasing, or divested themselves of, the securities of a company because of its actions in a particular country, these actions could have a foreseeable material impact on the company's ability to raise cash through the sale of its securities. In this case, a company would be required to disclose these material effects. A consumer boycott of a company might, likewise, have to be disclosed, if it were viewed as having a potentially material impact on the company's revenues.
- A company that wishes to sell its securities publicly in the United States must disclose factors that make an offering risky or speculative, which may include risk factors relating to operations in particular countries. Business risks imposed by political instability or the imposition of economic sanctions could be sufficiently probable and have a sufficiently significant magnitude to require disclosure.
- A U.S. company must disclose information about material pending litigation which is not routine or incidental to the company's business. For example, a lawsuit claiming environmental, personal, or other damage caused by the way a company performed its operations in a particular country might not be viewed as routine or incidental and might have to be disclosed, depending on its effect on the company's financial position or profitability. A foreign company must disclose litigation that may have, or has had in the recent past, a significant effect on the company's financial position or profitability.

Accordingly, existing SEC disclosure requirements might very well warrant disclosure of a foreign company's operations in, or business relationships with companies from, countries on the CIA's list of acquiring and supplying nations, the U.S. State Department's lists of sponsors of terrorism, and countries of particular concern.

Absent specific disclosure requirements relating to a company's operations in, or business relationships with companies from, countries on those lists, the question of whether disclosure is required will depend on the materiality of the financial impact of those operations and business relationships on the company's conduct of its business. SEC disclosure rules and policies turn on the concept of materiality. The Supreme Court has held that information is material if "there is substantial likelihood that a reasonable shareholder would consider it important in making an investment decision." TSC Industries v. Northway, Inc., 426 U.S. 438, 449 (1976).

In assessing materiality, the SEC staff takes the view that the reasonable investor generally focuses on matters that have affected, or will affect, a company's profitability and financial outlook. Because securities are financial investment vehicles, the materiality of a foreign company's operations in a particular country and its business

relationships with companies from that country will generally depend on whether these operations or relationships have had, or are likely to have, a financial impact on the company.

We agree that a reasonable investor would likely consider it significant that a foreign company raising capital in the U.S. markets has business relationships with countries, governments or entities with which any U.S. company would be prohibited from dealing because of U.S. economic sanctions. The staff will, therefore, seek information from foreign registrants about their material business in countries on OFAC's sanctions list and their business relationships with countries, governments, or entities on those lists. This type of disclosure would make available to investors additional information about situations in which the proceeds of an offering could – however indirectly – benefit countries, governments, or entities that, as a matter of U.S. foreign policy, are off-limits to U.S. companies.

Whether a reasonable investor, as a general matter, would view as material a foreign registrant's operations in or business dealings with other countries is less apparent. Although generally a company will disclose all countries in which it does business, information with respect to operations in these countries, particularly if immaterial, may be less relevant to investors. If, however, a foreign company's operations in a particular country and its business relationships with companies from that country have had, or are likely to have, a financial impact on the company, the staff will seek information from the registrant to address any deficiencies in the disclosure. As always, the staff will look to the SEC rule that requires a company to disclose any information if its absence would make the rest of its disclosure misleading. We will, in addition, continue to monitor investor interest in this area and adjust our disclosure practices if it appears warranted.

As a general matter, our disclosure requirements focus on the consolidated operations of the company that is registering securities and the subsidiaries and affiliated companies that it controls. Required disclosures identify parent companies and other major shareholders and explain their control relationship with the registrant. This kind of limited disclosure is material to an investor because the economic return on the investor's securities will be derived from the operations of the registrant. The economic return will not, however, be derived from operations of the registrant's parent company or those companies under common control. Thus, extensive information about parent companies and companies under common control with the registrant might be misleading to investors who are not purchasing securities in those companies.

- 2. Internal Corporate Risk Analysis: Foreign companies should disclose steps taken to identify and assess risks associated with doing business with countries and companies referenced above. This should include particular economic risks associated with these countries and companies as well as U.S. domestic political risks, including prospective U.S. governmental and non-governmental opposition to these activities (e.g. precedents). The foreign firm should outline what specific steps have been taken to ensure that the company, and its shareholders, are protected from these risks.*

When a foreign company initially registers its securities with the SEC, and thereafter in its annual report on Form 20-F, a foreign company is required to prominently disclose risk factors that make an investment in the company speculative or one of high risk. This requirement can be found under "Item 3.D – Key Information; Risk Factors" of Form 20-F, which sets out the disclosure requirements applicable to foreign companies registering securities and filing annual reports with the SEC. These risk factors may include factors relating to the countries in which the foreign company operates. When a company has material operations in countries with developing political and economic systems, there is typically disclosure about the various risks associated with these systems. These risks often include risks relating to exchange rate, undeveloped legal systems, economic uncertainty, high rates of inflation and government intervention in the economy.

As noted above, we will review filings to determine whether foreign companies have material operations in countries that are subject to OFAC sanctions. If it is reasonably likely that U.S. governmental sanctions will be imposed on the company as a result of its operations in a particular country, this risk would need to be disclosed if the sanctions were likely to have a material impact on the company. Likewise, if it is reasonably likely that public opposition to the company would have a materially adverse effect on the operations of the company, this risk would also need to be disclosed.

We note that considerations of materiality include considerations of probability and magnitude. It is often very difficult for a company to assess whether one aspect of its worldwide operations will give rise to the type of impact that would need to be disclosed under the federal securities laws, especially when there are considerations relating to public reaction and governmental responses. We do not believe that a requirement to discuss protective measures would elicit meaningful information for investors because we would expect that all companies would disclose that they take steps to avoid governmental sanctions and adverse public reaction to their operations.

- 3. Accounting Procedures: While it is understood, and disclosed, that accounting procedures vary from region to region, firms should disclose what steps have been taken to ensure that operations outside their home market are subject to accounting standards that American investors can rely on.*

Foreign companies that register securities with the SEC are generally required to adopt U.S. standards on a worldwide basis in connection with the preparation of their audited financial statements. Outlined in the following paragraphs are our requirements with respect to U.S. generally accepted accounting principles (GAAP), U.S. generally accepted auditing standards (GAAS), and auditor independence.

*Accounting Principles.* The financial statements of a company that registers securities with the SEC must include an audited balance sheet covering the last two fiscal years and audited income statements, cash flow statements and statement of changes in stockholders' equity covering the last three fiscal years.

A U.S. company is required to prepare these financial statements using U.S. GAAP, which are established by the Financial Accounting Standards Board. Foreign companies that register securities with the SEC may prepare their financial statements using either U.S. GAAP or another GAAP if they include a textual and numerical reconciliation of their foreign GAAP financial statements to U.S. GAAP. In an initial registration statement, a foreign company must provide financial information that is reconciled to U.S. GAAP for at least the two most recent years. In subsequent years, a foreign company must provide U.S. GAAP financial information for up to the past five fiscal years. When a foreign company uses accounting principles other than U.S. GAAP, those accounting principles must constitute a comprehensive basis of accounting.

*Audit Requirements.* The audit of financial statements included in registration statements and annual reports filed with the SEC must be conducted in accordance with U.S. generally accepted auditing standards. These standards have been developed by the American Institute of Certified Public Accountants and are required to be applied on a worldwide basis to the company that is being audited. As a result, if a publicly traded U.S. corporation has foreign operations, those foreign operations would be subject to the same audit procedures as the company's U.S. operations. Likewise, a foreign company whose securities are registered with the SEC must apply U.S. GAAS to all of its operations.

Until September 2000, the SEC staff had a practice of accepting audit reports for foreign companies that stated the audit was conducted in accordance with foreign auditing standards that were "substantially similar in all material respects" to U.S. GAAS. We have changed our practice and no longer permit this type of report. An auditor's report must state unambiguously that the audit was performed in accordance with U.S. GAAS.

*Independence Requirements.* A company's auditors must comply with the SEC's independence standards. Over the past year, the SEC has made significant revisions to our independence standards for auditors. The substantive requirements of these new standards is beyond the scope of this memorandum, although we would be pleased to elaborate on these standards if you so request. For purposes of this recommendation, we note that these new standards apply to auditors on a worldwide basis and apply equally to U.S. companies and foreign companies that are registered with the SEC.

4. *"Disclosure Goals": While the U.S. should avoid any undue influence on foreign market exchanges, foreign companies should disclose what steps have been taken by their country and home markets to ensure transparency, independent oversight and accountability.*

Although our rules do not specifically require a foreign company to disclose factual information relating to its country of incorporation or the country in which it principally operates, many foreign companies do provide this type of information in their disclosure documents filed with the SEC. To the extent a company includes information of this type in a prospectus filed with us, this information generally consists of basic economic

information relating to the relevant country. Often, a company will also include a description of its home country financial market and stock exchange or other trading market.

General information about governmental or private initiatives to improve transparency, oversight and accountability would not appear relevant to an investor except to the extent that these types of initiatives may have an effect on the company. To the extent a company is reasonably likely to be materially affected by these types of initiatives, they would be required to be disclosed. Companies may be liable for misstatements and omissions of material information in their documents filed with the SEC and therefore companies generally are reluctant to include in their SEC registration documents information over which the company has no or little control or means to verify. In addition, we would discourage the inclusion of information that is not directly relevant to a company that is registering securities because investors could be misled with respect to extraneous information.

*5. Board of Directors. Much like requirements for U.S. companies, the SEC should require full disclosure with respect to the firm's Board of Directors including: name, age, organizational affiliations, prospective conflicts of interest, whether they own stock in the company and whether they attend Board meetings.*

When a foreign company initially registers its securities with the SEC, and annually thereafter for so long as the company continues to be registered, a foreign company is required to disclose information about its directors, officers and significant employees. These requirements are set out in "Item 6 - Directors, Senior Management and Employees" of Form 20-F. These requirements include name, age, areas of experience in the company, principal business activities performed outside the company, and share ownership in the company (unless the share ownership is less than 1%).

Foreign companies are also required to disclose transactions or loans for the last three fiscal years between the company and various related individuals and entities. These include officers, directors, other key management personnel, and major shareholders. This disclosure requirement would apply to transactions with a company that is directly or indirectly under common control with the registered foreign company. This disclosure requirement also applies to close members of the families of officers, directors, key management personnel and major shareholders, and entities in which these individuals have a substantial voting interest. These requirements are set out in "Item 7 - Major Shareholders and Related Party Transactions" of Form 20-F.

U.S. companies are required to disclose in their proxy statements relating to shareholders' meetings involving the election of directors information relating to whether an incumbent director has attended fewer than 75% of the aggregate of the total number of board of directors and committee meetings in the prior fiscal year. This requirement is contained in "Item 7 - Directors and Executive Officers" of Schedule 14A under the Exchange Act, which governs the form and content of proxy statements used to solicit proxies from shareholders.

Because of differences in corporate law, there are fundamental differences between U.S. companies and foreign companies with respect to shareholders' meetings. For example, the corporation law in most states of the United States permits an extended period of time between setting a record date before a shareholders' meeting to determine holders eligible to vote at the meeting and the date of the meeting. This extended period provides an opportunity for proxies and proxy statements to be distributed to shareholders. The corporation laws of many foreign countries do not permit such an extended period, making the solicitation of proxies impracticable. Some foreign corporation laws do not permit the setting of record dates at all. In addition, some foreign corporation laws mandate that notice of a shareholders' meeting be made by publication in a newspaper or official publication rather than a notice sent to holders.

Because of these substantial differences, the SEC has not regulated the form and content of proxy statements or other shareholder materials used by registered foreign companies in connection with shareholders' meetings. Matters relating to shareholders' meetings generally involve the internal corporate governance of a corporation. It would be impracticable to design proxy regulations that address all of the different foreign corporation laws of the foreign companies that are registered with the SEC.

6. *Minority Shareholder Rights: The firm should provide a detailed accounting of its protection of shareholder rights and the process by which grievances and resolutions are presented and considered.*

A foreign company that is registering equity securities with the SEC is required to disclose information that describes the rights and restrictions relating to the securities. Matters that are specifically required to be addressed include any limitations on the right to own securities or to hold or exercise voting rights. In addition, to the extent shareholder rights are significantly different in the foreign country from those in the United States, the foreign company must explain the effect of these differences. These requirements can be found under "Item 10.B – Additional Information, Memorandum and Articles of Association" of Form 20-F.

A foreign company is also required to disclose whether investors may bring actions under the civil liability provisions of the U.S. federal securities laws against the company, its officers and directors, and its underwriters and experts that are residents of a foreign country. This disclosure must address enforceability of judgments, service of process, and other matters. These requirements can be found under "Item 101(g) – Enforceability of Civil Liabilities Against Foreign Persons" under Regulation S-K.

7. *Governmental Official Ownership. The firm should disclose what government officials, if any, have direct – or indirect – ownership in the company.*

A foreign company that is registering securities with the SEC is required to disclose the identities of any person or entities that beneficially own 5% or more of each class of the company's voting securities, unless the company is required to disclose a lesser

percentage in its home jurisdiction, in which case the lesser percentage applies. This requirement extends to foreign governmental entities and officials. We believe that to the extent a company is aware of a material conflict or similarity of interest with a regulatory agency or governmental body that may have an impact on the financial prospects of the company, then the company would be required to disclose this conflict or interest.

*8. Electronic Filing: Former SEC Chairman Levitt agreed to make foreign filings available electronically on the "EDGAR" website. At this time, this step has not been implemented. Foreign filings should be made available immediately to U.S. investors electronically.*

When the Commission first adopted rules in 1993 to phase in electronic filing for U.S. companies, we excluded foreign issuers from the mandatory electronic filing requirement, although we allowed them to file electronically on a voluntary basis (and over 200 foreign companies currently do). We excluded foreign companies from the mandate for a number of reasons, one of which was our belief that foreign issuers might face higher transaction costs from the implementation of electronic filing than would be borne by U.S. companies. Also at the time, there was limited public availability of the Internet and the World Wide Web, and we did not foresee that documents that were filed with us electronically could be made available for free to the public at large.

We agree that the time has come to require foreign issuers to file their registration statements, annual reports and other documents with us electronically so that these documents will be available through our website and through commercial vendors. The technological and costs arguments against mandated electronic filing have been reduced, and investor demand for this information continues to increase.

Under the Administrative Procedure Act, the Commission must first publish proposals in this area for public comment. We expect that the Division of Corporation Finance will be able to prepare a draft release proposing to mandate electronic filing for foreign companies, and recommend that the Commission publish this release, in the early summer 2001.

*9. Annual Risk Disclosure: Exemption 12g3-2(b) which exempts foreign firms from annual filings (and, instead, allows the company to file those documents required by their home exchange) should be eliminated. The SEC has recently begun to require domestic firms to disclose "Risk Factors" in their annual 10-K filings. The same standard should be applied to foreign firms with respect to their annual 20-F or 40-F filings.*

This recommendation requires that we separately discuss Exchange Act Rule 12g3-2, Form 20-F disclosure requirements, and Form 40-F under the multijurisdictional disclosure system for Canadian companies.

- a. Exchange Act Rule 12g3-2. Companies with total assets of \$10 million or more and a class of equity securities held of record by 500 or more persons (wherever

they reside) are required to register that class of securities pursuant to Section 12(g) of the Exchange Act. Registration under Section 12(g) subjects the company to the periodic reporting requirements of the Exchange Act.

Rule 12g3-2 under the Exchange Act contains two exemptions from the Section 12(g) registration requirements. The exemptions are available only to foreign companies.

The first exemption is found under Rule 12g3-2(a). Under this rule, a class of equity securities of a foreign company is exempt from registration under Section 12(g) if there are fewer than 300 holders of the class resident in the United States. This exemption is self-executing and requires no action by the issuer or SEC staff.

The second exemption is found under Rule 12g3-2(b), which is known informally as the "information supplying exemption." This exemption is conditioned on the foreign company furnishing to the public through the SEC's public reference facilities certain information. This information includes such items as the annual report to shareholders, press releases, statutory filings and other documents that would be material to an investment decision that the company makes public voluntarily or pursuant to home country or stock exchange rules. Foreign companies establish this exemption by sending materials to the SEC, which the SEC staff then makes public through our public reference facilities. SEC staff does not undertake any type of substantive disclosure or accounting review of materials furnished pursuant to Rule 12g3-2(b).

Rule 12g3-2(b) was adopted by the SEC in 1968 in order to provide an exemption from Section 12(g) registration for foreign companies that have not by their own volition accessed the U.S. public capital markets. As a result, the Rule 12g3-2(b) exemption is not available to foreign companies if their securities are traded on the New York or American Stock Exchanges or any other national securities exchange, on the Nasdaq Stock Market, or on the Over-the-Counter Bulletin Board market that is operated by Nasdaq. (There are a small number of foreign companies whose securities are "grandfathered" on those markets because they have been continuously traded on those markets prior to the effective date of various regulations.) The Rule 12g3-2(b) exemption is also not available if the company has previously registered any offering of securities under the Securities Act.

We do not believe that elimination of this exemption is appropriate. We believe there could be jurisdictional and enforcement questions if our rules required a foreign company to register with us even though that company had undertaken no activities in order to access the U.S. public capital markets, particularly since there is no prohibition on U.S. investors purchasing the securities of foreign companies in markets outside the United States. The elimination of Rule 12g3-2(b) could result in many foreign companies restricting

the ability of U.S. investors to purchase their shares, thereby limiting the investment opportunities available to U.S. investors.

We believe that Rule 12g3-2(b) strikes an appropriate balance in this area because foreign companies that rely on this exemption do not have full access to the U.S. public capital markets. These companies:

- May not have their securities traded on a national securities exchange, on the Nasdaq Stock Market or on the Over-the-Counter Bulletin Board;
  - May not raise capital through a registered public offering in the United States; and
  - May not have acquired in a share exchange transaction another company that is registered with the SEC.
- b. Risk Factor Disclosure in Form 20-F. A foreign company is required to disclose "Risk Factors" in its prospectus relating to its initial public offering and then at least once a year thereafter in its annual report that is filed with the SEC. This requirement can be found under "Item 3.D – Key Information; Risk Factors" of Form 20-F. This risk factor information is required to be disclosed prominently. This type of disclosure has been required for many years. See Securities Act Release No. 6437 (November 19, 1982).
- c. Form 40-F. Form 40-F is part of a mutual recognition system that the SEC has in place for Canadian companies. This system, known as the MJDS (or multijurisdictional disclosure system), permits eligible Canadian companies to register and report with the SEC using documents prepared in accordance with Canadian disclosure requirements. Canadian securities regulators have in place a counterpart to the MJDS for U.S. companies.

The MJDS was one of the SEC's early efforts to address the challenges of the increasing integration and internationalization of the world's securities markets. The MJDS grew out of a concept release published in 1985 on facilitation of multinational securities offerings. The MJDS was initially proposed in 1989 and, after a reproposal in 1990, was adopted in 1991.

The MJDS permits larger Canadian companies to file registration statements and annual reports with the SEC using the disclosure documents they file in Canada. As a result, the contents of documents filed under the MJDS are mandated by the disclosure requirements of the Canadian securities regulators, rather than the SEC's.

For a variety of reasons, SEC staff has been considering whether to revise the MJDS and has been in discussions with staff at the Canadian securities regulators with a view to narrowing its scope. Any changes to the MJDS would

be subject to notice and comment under the Administrative Procedure Act and Commission approval.

*10. Universal Listing Standards: The SEC should report what steps it will take to help create universal listing standards for global exchanges.*

For over ten years, we have worked with securities regulators in other countries, both directly and through our membership in the International Organization of Securities Commissions (IOSCO), to facilitate the cross-border flow of securities and capital. One of the most important steps taken in this direction occurred in 1998, when IOSCO endorsed a core set of disclosure standards for the non-financial statement portions of a disclosure document relating to equity securities. This core set of standards is referred to as the International Disclosure Standards for Cross-Border Offerings and Initial Listings by Foreign Issuers (IDSs).

The IDSs are intended to be incorporated by IOSCO member countries as part of their disclosure requirements for prospectuses, offering and initial listing documents and registration statements for foreign companies. They represent a strong international consensus on fundamental disclosure topics, and can be used to produce offering and listing documents that contain the same high level of information that the SEC has traditionally required. At the time that it endorsed the IDSs, IOSCO encouraged its members to take whatever steps would be necessary in their own jurisdictions to accept disclosure documents prepared according to those standards. Acceptance by each IOSCO member country of the IDSs enables a foreign issuer to use a single disclosure document in cross-border offerings and listings, subject to the approval or review of the country in which the offering or listing is made. The SEC staff played an instrumental role in drafting the IDSs.

In September 1999, the SEC adopted revisions to its disclosure requirements for foreign private issuers in order to fully incorporate the IDSs. The revisions were made to Form 20-F and took effect on September 30, 2000. Form 20-F is the form used by foreign private issuers that wish to register a class of securities under the Exchange Act and to list a class of securities on a U.S. national stock exchange, and is also used for annual reports under the Exchange Act. The disclosure requirements set forth in Form 20-F also serve as the disclosure requirements in the registration statements used by foreign private issuers to make a public offering of securities registered under the Securities Act.

We believe that our adoption of the IDSs represents a key endorsement of the initiative to improve disclosure standards worldwide, and also represents an improvement in the quality of disclosure made to U.S. investors by registered foreign companies. In particular, as compared to our prior disclosure standards for foreign companies, revised Form 20-F requires improved disclosure in several areas, including with respect to transactions with management and other insiders, major shareholders, and the age of financial statements permitted in an offering document.

In addition to its work in the area of non-financial disclosure, the SEC has also actively supported efforts to develop accounting standards that could be used in cross-border offerings. SEC staff has been very active in working with the International Accounting Standards Board (IASB, formerly known as the International Accounting Standards Committee) both directly and through our participation in IOSCO.

In February 2000, the SEC published a Concept Release on International Accounting Standards which solicited comment on the elements needed to develop a high quality, global financial reporting framework for use in cross-border offerings and listings. The Commission received approximately 100 comment letters in response to this release. In addition, in May 2000, the Technical Committee of IOSCO completed a review and assessment of 30 core standards that had been promulgated by the IASB in recent years. As a result of this review, IOSCO recommended that its members allow multinational issuers to use these core standards, as supplemented by reconciliation, disclosure and interpretation, where necessary, to address substantive national issues in cross-border securities filings. Consistent with this recommendation, the SEC currently accepts international accounting standards issued by the IASB with reconciliation to U.S. GAAP for filings made by foreign companies.